

ACTIONS TAKEN TO IMPROVE THE EITC AND REDUCE ERRORS

The Earned Income Tax Credit (EITC) is a special credit for certain low-income taxpayers who work. It reduces the amount of tax owed and is intended to offset some of the increases in living expenses and social security taxes. A number of administrative and legislative actions have been taken to ensure that eligible individuals -- and only those individuals -- are able to claim the EITC. These actions taken together enhance the *simplicity* and *verifiability* of EITC claims.

If eligibility rules are *simple*, taxpayers can more accurately claim the EITC and avoid costly errors. If eligibility rules are *verifiable*, the IRS can better ensure that the EITC is paid only to those who are eligible.

Administrative Actions

- In 1994, the IRS shortened and simplified the Schedule EIC to make it easier for low-income taxpayers to understand whether they are eligible for the credit.
- Since the 1995 filing season, the IRS has validated the social security numbers (SSNs) of all EITC qualifying children and most dependent exemptions. During the 1995 filing season the IRS identified 4.1 million problems with SSNs on electronically filed returns; 1.3 million of these involved the EITC. Taxpayers were asked to correct the SSN problem before resubmitting the return. In 1996, there was a 25-percent drop in the number of electronic returns that had to be rejected because of missing, invalid or duplicate SSNs.
- During the 1995 and 1996 filing seasons, the IRS also intensified verification of SSNs on paper returns that claimed an EITC qualifying child or dependent exemption. This allowed the IRS to prevent about \$900 million in improperly claimed refunds from going out in FY 1996.
- During the 1995 filing season, the IRS slowed EITC refunds for over 4 million taxpayers who matched profiles of noncompliant taxpayers to verify they were correct.
- Since 1995 the IRS has no longer provided direct deposit indicators (DDIs) to preparers of electronic returns (EROs). The DDIs gave preparers a quick signal from the IRS that a taxpayer was going to receive a refund check. With the elimination of the DDI, EROs have greater incentives to check the eligibility of EITC claimants.

- In its enforcement activities, the IRS has also found that some EROs have been responsible for refund fraud. The IRS has taken several steps to stop this practice:
 - Fingerprint and credit checks are conducted on certain new ERO applicants.
 - IRS is conducting additional compliance checks to ensure that EROs are meeting new, stricter requirements for participating in the program.
 - The IRS is working with the Department of Justice to prosecute preparers and EROs who take advantage of the EITC to defraud the federal government.
- During the past three filing seasons, the IRS has been conducting studies of EITC compliance to better understand the magnitude and source of erroneous payments.

Legislative Actions

Omnibus Budget Reconciliation Act of 1993:

- The EITC was simplified by repealing the supplemental credit for health insurance coverage, with its complicated eligibility criteria. The supplemental credit for children under the age of one was also repealed.

Uruguay Round Agreement Act of 1994:

- The EITC was denied to nonresident aliens
- Prisoners are not eligible for the EITC based on their earnings while incarcerated.
- Taxpayers must provide a taxpayer identification number (generally an SSN) for each EITC qualifying child, regardless of age. This allows the IRS to verify eligibility for each child claimed by the taxpayer. This provision is being phased in over a 3-year period.
- The Department of Defense is required to report to both the IRS and military personnel non-taxable any earned income paid during the year that is included in computing the EITC. This will ensure that military personnel receive only the benefit for which they are eligible.

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996
(the welfare reform act):

- The IRS is authorized to use simpler and more efficient procedures when taxpayers fail to supply a valid SSN, beginning with the 1997 filing season.
- EITC is denied to undocumented workers.
- The IRS is authorized to use simpler procedures to assess EITC claimants for any outstanding self-employment tax liability.
- The amount of losses taxpayers can use to reduce their income for purposes of EITC eligibility is reduced.

The Health Insurance Portability and Accountability Act of 1996:

- EITC is denied to taxpayers with large amounts of investment income.

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